



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

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UIL Code:

4942.03-05

4943.03-01

Contact Person:

Identification Number:

Telephone Number

Employer Identification Number:

Legend:

L =

Company =

Trust =

Dear Sir or Madam:

This is in response to your request for rulings under sections 4942 and 4943 of the Internal Revenue Code ("Code") relating to your receipt and subsequent transfer of certain shares of stock.

Facts

You are an organization described in section 501(c)(3) of the Code and classified as a private foundation in section 509(a). You were created by L, who was the owner of all the outstanding stock of Company. Company is a closely held corporation having four classes of outstanding stock: voting common stock (the "Voting Common Stock") and non-voting common stock (collectively, the "Common Stock"); and two classes of non-voting preferred stock: cumulative First Preferred Stock and non-cumulative Second Preferred Stock (collectively, the "Preferred Stock").

During his lifetime, L transferred all of his Common Stock and Preferred Stock to a revocable trust (the "Trust"). The Declaration of Trust states that upon L's death, the Trust will distribute to you all the residue of the trust estate, which includes the Common Stock and the Preferred Stock. L died in 2001.

The Declaration of Trust states that within five years after you receive the Voting Common Stock from the Trust, you will retain 35 percent of the Voting Common Stock and will redistribute 65 percent of the Voting Common Stock equally to the five public charities identified in the Declaration of Trust. The Declaration of Trust gives the trustees of the Trust broad discretion with respect to the distribution of the Voting Common Stock. In pertinent part, the Declaration of Trust states:

After the death of Grantor, the Trustees shall have broad discretion, exercisable by them at any time and from time to time, with respect to the identity of the charitable recipients and the amounts, nature and character of property distributed to each, including specifically the powers to

vary the percentages set forth in Schedule II to remove the entities specified in such Schedule in whole or in part, to substitute or add other entities therefore or decline to do the same; provided , however, that such organizations shall be described in Section 501(c)(3) and Section 509(a)(1), (2) or (3) of the Internal Revenue Code and shall be organized and operated exclusively for such purposes as are described in Section 501(c)(3) of the Code or to the federal government or to a state or local government for such purpose.

Company's Articles of Incorporation ("Articles") state that only the holders of the Voting Common Stock have the power to vote for the election of Directors. Holders are entitled to one vote for each share held. Cumulative voting is not permitted. The Articles do not describe any circumstances where the holders of the non-voting common stock would have the right to vote. No additional shares of Common Stock may be issued without the unanimous consent of the holders of 80 percent of the outstanding Voting Common Stock.

Company's Articles state that the holders of the Preferred Stock do not have the right to vote, except where the proposal is to amend the Articles to make any changes in the rights associated with the Preferred Stock, or where a proposed merger or sale of assets would alter the number of shares of Preferred Stock or change any of the rights associated with the Preferred Stock.

As long as any shares of either class of Preferred Stock are outstanding, Company cannot, without the consent of the holders of a majority of the outstanding shares of the particular class of Preferred Stock, either (i) amend the Articles so as to make any changes that would adversely affect the class of Preferred Stock outstanding, or (ii) merge Company or sell or lease all or substantially all of its assets, unless the holders of the class of Preferred Stock outstanding receive the same rights as before the transaction.

The Preferred Stock does not have any relative or special rights and powers other than as described above. No shares of Preferred Stock may be issued without the unanimous consent of the holders of 80 percent of the Voting Common Stock.

The Bylaws of Company state that Directors are elected by a simple majority vote. However, in the case of the following extraordinary Company actions, the approval of 85 percent of the outstanding voting shares (a "Supermajority") is required:

1. Making a "fundamental change" as defined in the state's business corporation law, or making a corporate distribution;
2. Issuing voting shares of Company;
3. Selling, transferring, or exchanging the rights to real property in excess of a certain value or percentage of current net assets of Company;
4. Acquiring a company or assets greater than a certain dollar value or percentage of Company's current net assets;

5. Changing the shareholder agreement; and
6. Changing this bylaw provision requiring a Supermajority vote.

There is no agreement between Company and the Trust that gives Company a right of first refusal in the event a current or future shareholder of Voting Common Stock intends to sell or otherwise transfer any of its Voting Common Stock.

In 2006, you formed five charitable organizations (the "Supporting Organizations") solely for the purpose of supporting five public charities (the "New Public Charities"). Some of the New Public Charities are the same as and some are different from the public charities identified in the Declaration of Trust. Each Supporting Organization is recognized as an organization described in section 501(c)(3) of the Code and classified as a supporting organization under section 509(a)(3). The Bylaws of each Supporting Organization state that it will be operated to support a specified New Public Charity ("Supported New Public Charity") and that it "shall make grants to support programs and further the purposes of the [Supported New Public Charity]." The Bylaws of each Supporting Organization include conflicts of interest provisions.

The Bylaws of each Supporting Organization state that:

- It has seven directors, four of whom the Supported New Public Charity appoints and three of whom you appoint.
- Amending the Bylaws requires a majority vote of the Directors appointed by the Supported New Public Charity and a majority vote of the Directors you appoint.
- None of its Directors appointed by the Supported New Public Charity may be a family member of or an employee of Company.
- To constitute a quorum, a majority of the Directors appointed by the Supported New Public Charity must be present.
- The officers are elected by the Directors appointed by the Supported New Public Charity.

Under the Declaration of Trust, when the trustees distribute to you the Voting Common Stock, they will request that you retain 20 percent of the Voting Common Stock and distribute 80 percent of the Voting Common Stock to the five Supporting Organizations. Thus, you will retain 20 percent of the Voting Common Stock and will distribute 16 percent of the Voting Common Stock to each of the five Supporting Organizations. In addition, you will retain all of Company's nonvoting common stock and all of its Preferred Stock.

Rulings Requested

1. Your ownership of Voting Common Stock will not constitute excess business holdings within the meaning of section 4943 of the Code, provided you distribute at least 80 percent of the Voting Common Stock to the Supporting Organizations within the five-year period from the day the stock is distributed to you from the Trust.
2. The Supermajority requirements in Company's bylaws will not cause your ownership of Voting Common Stock to constitute excess business holdings within the meaning of section 4943 of the Code.
3. Your distribution of Voting Common Stock to the Supporting Organizations pursuant to the terms of the Trust will constitute a qualifying distribution under section 4942 of the Code.

Law

Section 4942 of the Code imposes an excise tax on the "undistributed income" of a private foundation for a taxable year.

Section 4942(c) of the Code defines the term "undistributed income" as the excess of the distributable amount for the taxable year over the "qualifying distributions" made from the distributable amount.

Section 4942(g)(1)(A) of the Code defines the term "qualifying distribution" as any amount paid to accomplish one or more purposes described in section 170(c)(2)(B) other than a contribution to an organization controlled, directly or indirectly, by the foundation or disqualified persons with respect to the private foundation.

Section 53.4942(a)-3(a)(3) of the Foundation and Similar Excise Taxes Regulations ("regulations") states that a donee organization is controlled by a private foundation, or by one or more disqualified persons with respect to the foundation, if any such persons may, by aggregating their votes or positions of authority, "require the donee organization to make an expenditure, or prevent the donee organization from making an expenditure, regardless of the method by which the control is exercised or exercisable."

Section 4943 of the Code imposes excise taxes on the excess business holdings of any private foundation in a business enterprise.

Section 4943(c)(1) of the Code provides that excess business holdings are the amount of stock in a corporation a private foundation owns that exceeds its permitted holdings. Permitted holdings are 20 percent of the corporation's voting stock less the percentage of the voting stock owned by all disqualified persons.

Section 4943(c)(6) of the Code provides a five-year period during which a private foundation may dispose of excess business holdings that it has acquired other than by purchase.

Section 53.4943-3(b)(1)(ii) of the regulations states that voting stock is determined by reference to the power of stock to vote for the election of directors. The fact that extraordinary corporate action (e.g., charter or by-law amendments) by a corporation may require the favorable vote of more than a majority of the directors, or of the outstanding voting stock, of such corporation shall not alter the determination of voting power of stock.

Section 53.4943-3(b)(2) of the regulations states that permitted holdings in a corporation include non-voting stock held by the foundation where disqualified persons do not hold more than 20 percent of the voting stock of the corporation, and that all equity interests that do not have voting power are classified as non-voting stock. In addition, stock with voting rights that will vest only when conditions, the occurrence of which are indeterminate, have been met, such as preferred stock which gains voting rights only if no dividends are paid, will be treated as non-voting stock until the conditions have occurred that cause the voting rights to vest.

Analysis

Rulings No. 1 and 2

Under section 4943(c)(6) of the Code, you have five years from the date you receive the Voting Common Stock from the Trust to dispose of sufficient Voting Common Stock to bring your ownership of Voting Common Stock to the 20 percent level permitted under section 4943(c)(1). Section 53.4943-3(b)(1)(ii) of the regulations states that voting stock is determined by reference to the power of stock to vote for the election of directors. The fact that extraordinary corporate action, such as charter or bylaw amendments, may require the favorable vote of more than a majority of the directors, or of the outstanding voting stock, of such corporation does not alter the determination of voting power of stock.

After you receive the distribution of Common Stock and Preferred Stock from the Trust, you intend to distribute 80 percent of the Voting Common Stock to the Supporting Organizations by distributing 16 percent to each of the five Supporting Organizations, and to retain 20 percent of the Voting Common Stock, all of the non-voting common stock, and all of the Preferred Stock.

Company's Articles state that only the holders of the Voting Common Stock have the power to vote for the election of Directors. Thus, the Supporting Organizations, which will own collectively 80 percent of the Voting Common Stock, will together have the power to elect 80 percent of Company Directors, and you will have the power to elect 20 percent of Company Directors. The Articles do not describe any circumstances where the holders of the non-voting common stock would have the right to vote. The Articles expressly state that the holders of the Preferred Stock do not have the right to vote, except in certain limited circumstances involving the potential diminution of rights associated with the Preferred Stock.

Therefore, under the Articles, your ownership of the non-voting Common Stock and the Preferred Stock does not give you any voting power with respect to the election of Company Directors in addition to that which you already have through your ownership of 20 percent of the Voting Common Stock. In addition, section 53.4943-3(b)(2) of the regulations provides that

stock having voting rights that will become effective only upon the occurrence of indeterminate conditions will be treated as non-voting stock until the conditions have occurred. Thus, until any of the conditions occur that would give the holders of Preferred Stock the power to vote, the Preferred Stock will continue to be treated as non-voting stock for purposes of section 4943 of the Code, and you will have no voting power with respect to the election of Company Directors in addition to that which you already have through your ownership of 20 percent of the Voting Common Stock.

The Bylaws of each Supporting Organization state that you appoint three of each organization's seven Directors and the Supported New Public Charity appoints four. The Bylaws also state that amending the Bylaws requires a majority vote of the Directors elected by the Supported New Public Charity and a majority vote of the Directors you appoint; that none of the Directors of the Supporting Organization appointed by the Supported New Public Charity may be a family member of L or an employee of Company; that to constitute a quorum, a majority of the Directors of the Supporting Organization appointed by the Supported New Public Charity must be present; and that the officers of each Supporting Organization are elected by the Directors appointed by the Supported New Public Charity. Therefore, through your ability to appoint three of the seven Directors of each Supporting Organizations, you will not have, either directly or indirectly, any voting power with respect to the election of Company Directors in addition to that which you already have through your ownership of 20 percent of the Voting Common Stock.

The Supermajority provisions of the Bylaws require that certain extraordinary Company actions require a vote of 85 percent of the voting shares rather than a simple majority. After you distribute 80 percent of the Voting Common Stock to the Supporting Organizations, your ownership of 20 percent of the Voting Common Stock will enable you to prevent Company from taking any of these actions. However, because none of these Company actions involves the election of Company Directors, as a result of your power to block any of these actions, you do not have, either directly or indirectly, any voting power with respect to the election of Company Directors in addition to that which you already have through your ownership of 20 percent of the Voting Common Stock. Section 53.4943-3(b)(1)(ii) of the regulations.

Accordingly, after you distribute 80 percent of the Voting Common Stock to the Supporting Organizations by the end of the five-year period described in section 4943(c)(6) of the Code, your ownership of the remaining 20 percent will constitute permitted holdings in Company within the meaning of section 4943(c)(1) and section 53.4943-3(b)(1)(ii) of the regulations, notwithstanding: (a) your ownership of all the non-voting common stock and all the Preferred Stock of Company; (b) your power to appoint a minority of Directors of each of the Supporting Organizations; and (c) the provisions in Company Bylaws relating to certain extraordinary Company actions requiring Supermajority votes.

Ruling No. 3

A "qualifying distribution" for purposes of section 4942(c) of the Code does not include a contribution to an organization controlled, directly or indirectly, by the private foundation or by a disqualified person with respect to the private foundation. Section 4942(g)(1)(A). A donee organization is controlled by a private foundation or by a disqualified person if such persons, by

aggregating their votes or positions of authority, may require or prevent the donee from making an expenditure. Section 53.4942(a)-3(a)(3) of the regulations.

The Bylaws of each Supporting Organization state that of each organization's seven Directors, you appoint three and the Supported New Public Charity appoints four; that amending the Bylaws requires a majority vote of the Directors elected by the Supported New Public Charity and a majority vote of the Directors you elect; that none of the Directors of the Supporting Organization appointed by the Supported New Public Charity may be a family member of L or an employee of Company; that to constitute a quorum, a majority of the Directors of the Supporting Organization appointed by the Supported New Public Charity must be present; and that the officers of each Supporting Organization are elected by the Directors appointed by the Supported New Public Charity. Consequently, you cannot amend a Supporting Organization's Bylaws without the consent of a majority of the Directors elected by the Supported New Public Charity.

Therefore, under the Bylaws of each Supporting Organization, you do not have the power, directly or indirectly, to require a Supporting Organization to make an expenditure or to prevent it from making an expenditure. Accordingly, under section 4942(g)(1)(A) of the Code, you do not control, directly or indirectly, any of the Supporting Organizations. As a result, your distribution of the Voting Common Stock to each of the Supporting Organizations will not be precluded from constituting a "qualifying distribution" within the meaning of section 4942(c).

Rulings

1. Your ownership of Voting Common Stock will not constitute excess business holdings within the meaning of section 4943 of the Code, provided you distribute at least 80 percent of the Voting Common Stock to the Supporting Organizations within the five-year period from the day the stock is distributed to you from the Trust.
2. The Supermajority requirements in Company's bylaws will not cause your ownership of Voting Common Stock to constitute excess business holdings within the meaning of section 4943 of the Code.
3. Your distribution of Voting Common Stock to the Supporting Organizations pursuant to the terms of the Trust will constitute a qualifying distribution under section 4942 of the Code.

This ruling will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, *Notice of Intention to Disclose*. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

This ruling is directed only to the organization that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent.

This ruling is based on the facts as they were presented and on the understanding that there will be no material changes in these facts. This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described. Because it could help resolve questions concerning your federal income tax status, this ruling should be kept in your permanent records.

If you have any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

In accordance with the Power of Attorney currently on file with the Internal Revenue Service, we are sending a copy of this letter to your authorized representative.

Sincerely,

Steven Grodnitzky
Manager
Exempt Organizations
Technical Group 1

Enclosure:
Notice 337